



April 16, 2019

An Open Letter to the North Carolina General Assembly: Adopt Pro-Taxpayer Changes to SB 622 and HB 676

Dear Legislator,

On behalf of National Taxpayers Union (NTU) and Taxpayers Protection Alliance (TPA), we write to offer our comments regarding companion bills Senate Bill 622 and House Bill 676, the Tax Reduction Act of 2019. The Tax Reduction Act would offer tax relief to millions of taxpayers and businesses across North Carolina - an objective both NTU and TPA strongly support. However, it also contains some provisions that would raise taxes, hinder the state's competitiveness, complicate tax administration, and move away from sound tax policy. As such, we urge you to reconsider these ill-advised sections as you continue negotiations on a final package that will ultimately benefit all taxpayers and employers.

Over the last couple years, North Carolina has led the way in simplifying its tax code by broadening the tax base and lowering marginal tax rates. These pro-growth reforms, approved by the General Assembly, have greatly improved the state's tax code, while providing significant tax relief to individuals, families, and employers across the state. To that end, North Carolina's responsible approach to tax reform has served as a model for other states who have made pro-growth changes to their respective tax code.

We applaud lawmakers for their commitment to build upon this success by offering the Tax Reduction Act, which features a number of provisions that benefit taxpayers and businesses. Unfortunately, the legislation misses the mark in some areas, such as the inclusion of an audience-based calculation of broadcasters' tax liability and the application of sales tax on sellers based across state lines. NTU and TPA are pleased to offer our recommendations for SB 622 and HB 676 as you prepare to take them up in a Senate committee hearing.

Relief for Taxpayers and Small Businesses

To complement individual income tax rate reductions enacted in 2013, lawmakers in the General Assembly have approved five increases the standard deduction over that time period. If enacted, the Tax Reduction Act would once again boost the standard deduction from \$20,000 to \$20,750 for joint filers, and from \$10,000 to \$10,375 for single filers and married couples filing separately, starting in tax year 2021. By increasing the standard deduction, it will reduce the income and wages subject to state taxation, which will lead to a lower tax liability for nearly every filer who takes the standard deduction.

Market-based Sourcing

Part III of SB 622 and HB 676 proposes to implement market-based sourcing for apportionment of tax liabilities. It contains a highly problematic provision that would shift to an "audience-based" corporate tax apportionment system for broadcasters and content-producers. In recent years, most states have moved away

from this type of outdated system, with Massachusetts being the only state to adopt an audience-based approach in the last dozen years.

An audience-based system creates compliance and administrability problems because it fails to recognize that content providers do not have direct commercial interaction with viewers. As a consequence, content creators do not have the requisite information – billing information, for instance – about the location of the consumers of the content in order to determine their tax liability. By and large, content creators derive no revenue directly from viewers.

Instead, many states have opted for a “commercial domicile” approach. This has been adopted in Kentucky, Wisconsin, Tennessee, Texas, Iowa, Florida, Louisiana, Michigan, Illinois and Rhode Island. The commercial domicile approach taxes content creators based upon sales to in-state advertisers. As other states have learned, using this approach can significantly reduce compliance burdens and administrative hurdles while maintaining revenue neutrality.

Should the General Assembly move forward with such an approach, it is essential to minimize economic damage and tax complexity. Lawmakers could move in this direction by replacing the audience-based system with a commercial domicile approach that is based upon in-state commercial activity.

Remote Sales Tax

SB 622 and HB 676 have some positive aspects when it comes to taxation of remote sellers, but some concerning elements as well. Lawmakers included the safe harbor approved in *South Dakota v. Wayfair* in the draft legislation. These thresholds should ideally be scaled to take into account the fact that North Carolina is more than ten times larger than South Dakota in terms of both population and GDP, yet the South Dakota thresholds likely protect taxpayers from constitutional challenges. A ban on retroactive enforcement is likewise a positive inclusion.

Lawmakers’ interpretation of a marketplace facilitator as a person that “transmits the offer or acceptance for the sale of the items” is overbroad, however. This includes largely passive marketplaces that have in-site messaging, but no part of the payment process. This definition of a “marketplace facilitator” should be tweaked to ensure that only facilitators that take part in the payment process are subjected to collection liabilities.

Franchise Tax Changes

The Tax Reduction Act also makes notable improvements to North Carolina’s franchise tax regime, which is a step in the right direction as such taxes serve as a roadblock to capital investment in the state. Under current law, every business, including C-corporations and S-corporations, are subject to a \$1.50 tax for every \$1,000 in net worth value. This tax applies to assets like buildings, machinery, and patents. Thankfully, SB 622 and HB 676 provide relief for both small pass-through entities as well as corporations. Specifically, for S-corporations they would levy a flat \$200 tax on net worth on the first \$1 million, and gradually reduce the rate to \$1 per \$1,000 over \$1 million starting in tax year 2021. For C-corporations, they would gradually reduce the tax to \$1 per \$1,000 starting in tax year 2021. By gradually reducing the tax rate, it will free up capital for businesses to make decisions that impact their operations, like investing in new equipment, expanding to new locations, hiring workers, or rewarding existing employees with higher wages or other benefits.

NTU and TPA are pleased to see progress on reducing the franchise tax, and it is our hope that this progress will eventually lead to the elimination of the tax once and for all. Doing so would undoubtedly make the Tar Heel

State a more attractive place for capital investment and reaffirm North Carolina's commitment to low and responsible taxation policies.

We thank you for your consideration of these concerns and for all you do to protect North Carolina taxpayers.

Sincerely,

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